Wal-Mart Gold

Lesson Ten Transcript

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Joe: So, now we're to Section 10, which is how to start or buy a business.

Michael: Okay, is this harder than the JV section that we went over?

Joe: Yes it is. And this is the way that you can make the most potential money because if you either start or buy a business, build it up, then you can sell it for incredible amounts of money, but it is the hardest way to do it and the things that we're going to go over here I'm not going to try to give you everything you need to know on how to start a business. You can find 3-day courses on that topic. My idea was just to give you the highlights that I've learned and things I used from having done this four or five times myself.

The first thing is let's talk about starting a business first, is to decide whether you're going to be a manufacturing company or a marketing company. I've done both and I can tell you the manufacturing company I had had up to 300 employees and millions of dollars of equipment and was basically for me a big hassle to run. The marketing company, I only had nine employees and we got almost to the same level in sales and our margins were not that much worse.

For a lot of reasons I prefer being the marketing company. But there is one downside to that. Manufacturing companies are easy to finance. Banks and equipment leasing people will throw money at you to lease equipment, buy real estate, buy a building, and all that. If you have a marketing company, you don't have any physical assets. So, when we get to the financing section later, we'll talk more about this, but basically it's a lot harder to finance.

And the other thing to consider is buying a business and the thing that most people don't know is it is actually possible to buy a business with none of your own money down. And the best kind of business to buy, the ideal best kind is not one that's for sale, which has some logic behind it. If somebody has their business for sale there's usually a pretty good reason and they may not tell you that reason. It probably means that there's something wrong with it in some way, shape or form. But if you learn how to buy a business that's not for sale, then you're being proactive, you're finding the business that is in the industry you want, and is doing what you want, and then you're the only one talking to the owner about buying it.

If you're selling a business, you're going to use business brokers or other professionals to help you sell it and your goal in selling is to have a half a dozen people bidding to bid the price up to buy your business. So, that's best from the seller's point of view, but from the buyer's point of view, you want to be the only buyer.

Michael: From your experience, is it true that most of the businesses on the market that you'll see in the classified ads in the papers or listed by the brokers, usually most of these are dogs by the time its gotten there?

Joe: Yes, most of those are going to be not good, and like I said, there's a reason for they're for sale. I looked at one. There was a toy company out here in Colorado. They were asking a pretty good size chunk of money for the business. They wanted $500,000 to $1,000,000 for it and after I got a hold of their financial statements because I know how to analyze financial statements, it looked to me like they're going to be out of business in six months or sooner. So, I took a big pass on that. But on other businesses that I've looked at that are promoted to be sold, beware.

Michael: Have you spent the years looking at businesses for sale on the market?

Joe: I've done some of that. I've done some looking for businesses not for sale. I had a mail order company where I sold children's stickers to doctors, dentists, hospitals throughout the US and Canada, and when I sold that company to a very large competitor, then I was doing consulting for that competitor as part of the agreement, and one thing we did is we went out and looked for other companies to buy and I would go in there and analyze them for them. It helped them determine whether we wanted to buy this company or not and how much it was worth. So, in that case we were going out and finding companies. We were not looking for companies for sale.

Michael: Did you buy any?

Joe: They ended up buying one. The one they wanted to buy, it was pretty funny because it was another mail order company and it looked like it might be a good acquisition. But when we got into the analysis of it, we found out that the section of the company that my client planned on discontinuing was the only section that made money. And the part of the business they wanted was losing money hand over fist, so we didn't go through with that one. They did do another one later, though.

Michael: Well, let's get into what are some of the most important aspects of doing this buying or starting a business?

Joe: From the point of view, one of the critical things, if you're going to start a business or buy one, is your normally are going to need financing; you need some money. There are five critical things that an investor, a venture capitalist, an angel investor, anybody like that are going to look at. And the first one is you need a team. This is not an individual thing. This is not just you going and buying a business and you're going to run it by yourself kind of thing. You need a team of people. And that is interesting in that's the most important part if you're going for venture capital. The thing they look at first is the people. Second, you need the financial resources, obviously, which what we're talking about. The third part is what is the management ability of your team members? Have they done what they're going to be doing in your business before?

I've put together some presentations for venture capital people where in some cases we've had a management team where everybody on the team had done what we need to do in this business three or four times before. So, you can see that from an investor's point of view, here we're talking about starting a business and you've got four people on the team who have started and build businesses over $10 million and everyone is doing the niche of that that they've had the most experience already doing. So, you can see that somebody who is looking at investing would get a lot of comfort from that.

The next piece is the dedication and the enthusiasm of the entrepreneur. That the person who is founding the thing, the person who is spearheading it needs to have real fire and enthusiasm behind that. If they don't have that, that's a real red flag to any investors.

And actually last on the list is the product and the salability of the product. And the reason for that is what the venture people say, venture capital people say. Even if you have a good management team, even if you find out your product has got a flaw in it or is faulty or something is wrong with it, with that go do management team, you will be able to adjust and adjust the company around and do something else successfully. And if you don't have that management team, if that product dies or there's something wrong with the product, the company is bye-bye. So, I've been told that by venture capital people that that's why the team is the most important.

Michael: So, in this section on the four things from an investor's point of view, we're talking about raising money through venture capitalist. How much of the company, if we do get a venture capitalist to help us finance it, are they going to want?

Joe: Typically, and this is why I don't like venture capitalist, they'll want control of it. Typically what a venture capitalist does is they'll give you money, but you end up giving them control of the company. In other words, more than half of the stock and you will have incentives to get some of your stock back and to get your control back based on performing. So, they want to be able to do that so if you mess up, they have control of the company and they can liquidate it or do what they want with it.

On the other hand, if you use angel investors, which are pretty much more individuals as opposed to companies, that isn't usually the case. So, I've actually used all of those. I've used angel investors, I've used venture capitalists, and I definitely do not recommend the venture capital route. The only situation where it really makes sense is if you have some sort of break through technology and it's going to take a tremendous amount of money, $20 million or $30 million, and it's going to be five years before you have a product ready to sell, then you're pretty much a venture capital deal.

Michael: Now, you've mentioned products salability as last. Why is the product last? Isn't that essential?

Joe: Yes, it's essential to having a company and something to sell, but with the right management team, if the product's no good, they may tweak it or adjust it or modify it and end up with something that is good, whereas with the wrong management team, bad products with a bad team means bye-bye company. So, the skill of the people, the great management team, you may end up in a whole totally different business because you have the horsepower management wise to be able to figure all that out.

Michael: What about a business plan? What is a business plan and do I need one and why?

Joe: If you want money, you need a business plan. To operate your company, the kind of business plan you need to operate your company, you still need plans, action plans, and goals and all that, which I use to run any business I've ever had, but the business plan you use to get money is basically a sales document. You're basically saying here's how much money I need, here is what I need it for, and here's how I'm going to pay you back. And if you don't deal with those three things in your business plan to raise money, you won't get money. And it's like I mentioned earlier talking to a retail store buyer, you want to go through and prove every point. And especially if you're looking for somebody to give you $5 million, they're going to do what they call due diligence, which is they're going to check every fact and everything you say. And what you want to do is provide very hard evidence of the size of the market and provide hard evidence your product will sell. Every step along the way to proving your case to them why investing in your business is not as risky as it may seem. And basically investing is all about risk reward tradeoffs.

Michael: Now, how do I do a business plan? Should I take a chance to do one myself or should I get a book from the library or should I hire an expert to do it for me?

Joe: That will depend on what your experience is. For me, I can do one myself because I've done so many of them. If you've never done one before, you can get business plan software or books on business plans. But actually I have a friend of mine who is a venture capital or he sits on the board of a venture capital company and an angel network down in Arizona. His big claim that he's making -- he has some contacts on Wall Street in New York, investment bankers who put huge amounts of money into businesses and that's the sort of the way you approach them is different then the way you approach venture capital and the way you do your documentation is different. It's not a traditional business plan because the only way you get anywhere with an investment banker is through introductions. And it's a very interesting thing. He says all the business plan software out there and business plan books out there are all doing it the wrong way. And what we're going to end up doing is putting together an information product about how to do it right because one of his key contacts is somebody who s invested up to something line $400 million or $500 million into businesses and they have a different way of doing it.

But for now for the purposes of this program, doing it the traditional way at least for your own self so you make sure you consider everything. Consider if you're manufacturing, you've got a bunch of things to consider there. You've got administrative things to consider. You have all these different aspects of the business and you need to take a look at where you want o be in five years, define what the business will look like in five years and then work backward to now. So, I'm saying that for sure you want to the type of business plan that will help you manage the growth of your company. When it comes to raising money, there are some other alternatives that required documents done differently.

Michael: Now, can someone without any business experience really handle this?

Joe: Sure you can if you have the right team. If you don't have any experience -- say you're an inventor and you have experience in inventing the product, but you have no experience starting and running a business. That means you need to be the one in charge of R & D. When I got into my first joint venture with the guy who was doing screen-printing, his knowledge was technical knowledge and after we got our business a little bigger, we hired a VP of manufacturing, we hired a VP of personnel, we hired a VP of marketing and sales, and he turned out to be the VP of R&D. So, what you have to do is be willing to let go if in that case his expertise was R&D and so he did that and he was okay with doing that. He didn't feel like he had to be president.

The whole point is you need to know your strengths and weaknesses and what you need to do then is you need to get other people who have the expertise you don't, and that, in the case of most inventors and people who come up with products, that means you're going to have somebody else as president of the company, it won't be you. And that's one of the things that investors look at. If you think you can run the company and you've never run a company before, you're going to have a problem. If you get someone on your team to be president of the company who has experience doing it, you'll have a better chance of success and a better chance of raising money. Along that line I've started companies four or five times; three of them that were selling into the mass-market retail. And even though I've done it multiple times, my first one grew too fast. I got too big too soon and we ended up going out of business because we were way overextended financially. So, I got my real world MBA there as opposed to the MBA I got in school. So, I learned how to do it better the next time.

So, ideally what you want to do is learn from other people's mistakes so you don't have to make them. And the thing I learned there is I was the marketing guy, marketing and sales, and my partner was the manufacturing guy and we had a thing going between us. I said I can sell more stuff than he could ever make and he said I could make more stuff than you can ever sell. So, he went nuts buying million dollar pieces of equipment and I set up distribution and got national chains buying and we went nuts. I was trying to sell more than he could make. He was trying to make more than I could sell. But we didn't have anybody in charge of the money. Bad idea. So, that's what killed us. We didn't have any financial staying power and when the market took a dip for three or four months, it was enough to knock us out of business. Hey, it's not just marketing, not just making the stuff; somebody has to be on top of the financial part of it, which is actually critical.

Michael: Who do you recommend does it? Do you bring on and hire a CPA?

Joe: In that company, I had three CPAs, and the mistake I made is I took the CPA I had when we were a four-person business who was doing our taxes for us and we made him our VP of finance and that was a big mistake. He had no qualifications whatsoever to be a VP of finance, but I didn't know that at the time. And we had a couple of other CPA's in the accounting department too. So, CPAs are not VPs of finance. The VP of finance's main job is to make sure the business is funded. So, that means dealing with investors and things like that. And a CPA has the expertise to tell you what happened after it happened. That's what accounting is all about. Well, you need somebody who is looking forward, not backward and that's what the VP of finance has to do. He says we are going to in the future need this, this, and this. That means we need to arrange this funding. That means you cannot take this million-dollar order because if you do we won't be able to make payroll or whatever. So, you need someone looking forward, not looking back. You need CPAs too and you need accounting too because you do need to have accurate financial statements to run the business. But don't expect a CPA to help you be a VP of finance and look forward, they look backward.

Michael: What are some of the common pitfalls for successful businesses?

Joe: Well, the biggest one and the biggest way that you can start a business and end up with an 80-hour a week job is when you don't have systems. And there's a book called, *E-myth*, that if you haven't read that you should read that because that's what that's all about. But basically you need to have systems for every part of your business. And what that does is that allows you to grow the business. It allows other people to do things following the system and because an individual entrepreneur who starts a company might be doing everything himself at the beginning and the more he tries to do everything himself, as the thing grows it becomes impossible to do everything yourself with any kind of capability. And that can be the end of the business for a lot of entrepreneurial businesses. So if you set up systems then each of those systems can be expanded and other people can run each one.

Another good book I'd recommend is, *Rich Dad, Poor Dad*, and that series of books because Kiyosaki, in that book, has a definition of a real business, which I really like, and that definition is that you have a real business when you can go away for a year and come back to it, it's stronger than when you left. And that means you have systems because without systems when you come back it's gone.

Michael: All right. Give me your recommendations if I want to buy or start a business.

Joe: I have four criteria that I look at if I'm going to start a business around a product or buy a business. The first one is I want something that I can build up and sell and that is without me being there. So, what that means is a doctor, an accountant, lawyer or somebody like that who is a professional, they can have a business, but if they build up there expertise and all of that, if they want to sell a business and walk away, the expertise just walked away. So, the only way you're going to have a business that you can build up and sell is when you can make yourself not needed. You have systems, you have management, you have all of that and you own that business, but it needs to be, one, you can do that.

The second criteria I have, which I learned the hard way, is I like businesses that sell consumable products so that when you get a customer they're reordering. The sticker business was that way. But I had an Internet business selling a business opportunity in the promotional products industry for $1,000 and I sold 1,300 of those, but I didn't have any backend, so every sale had to be a new customer. That's a very difficult business to grow. If you want to double your sales next year, that means you have to get twice as many new customers next year. If you have a business that has ongoing reorders, if you want to double your sales next year, you just need to get as many customers as you already have. You don't have to replace all those other ones. So, businesses that sell consumable products that get used up are great because then when you get a customer that customer keeps buying, and that applies whether it's a mail order business or whether it's selling to retail, either way.

The third criterion is I'm looking for the hungry crowds. I want a business that supplying products or services to the hungry crowds. I want to be the only hamburger stand in the stadium, and they have a choice of me or don't eat. And that all I have to do to sell a hot dog or a hamburger is say that I have them and then stand back because they're swamping me. So, I like my business and my products are selling to be going to the hungry crowd and that's what I had with my sticker business. We were in the middle of a trend where everybody who produced anything that looked half way decent could sell it really easily and we had the hungry crowd.

And the fourth thing is something that changes, but that is being on trend and by on trend I mean in the trends in society that are happening. Don't swim against the stream, don't swim upstream, swim downstream. And one of the people who is good to pay attention to there is a woman named Faith Popcorn and she's written three books. One is *Popcorn Report*, one is *Clicking*, and one is *EVEolution*. And what these books are about are what are the trends that are happening now. And it's her contention that if your businesses -- out of the 15 or 16 trends that she identifies each year, if your business is on target with at least 4 of those, her contention is you'll have a hard time failing because you're going with the stream, you're going with the trends, and the demand is going up in those areas and if you conforming to as many of those things as you can, this is going to mean that your business is going to be successful.

One thing I'll tell you, the way to find her latest things, she does predictions for each year on trends. Go onto Google and put in Faith Popcorn 2006 predictions, and when you do that, you'll find the web site that has her 2006 predictions, which is such a long URL, I would not try to read it to you. And then you can do the same thing for 2005 or 2007. You'll be able to find that, but some of the things, I'll go over a couple of them that are in her 2005-2006 predictions because they're sort of interesting. One of them is she calls Big Mother and this is a trend where technology is going to help Moms keep track of the kids. They have classroom cams for little kids in schools. They have the RFID tags in backpacks. In case you didn't know about it, an RFID tag is a little chip that is being used by Wal-Mart and other retailers so they can track where a shipment is.

Michael: Wow, they're using those in backpacks now?

Joe: Yes. That what she says is coming.

Michael: I believe it.

Joe: RFID tags in backpacks, and then also GPS chips in watches. And she says, or to the extreme, even embedded in the kid's body.

Another one, which she calls persona propaganda, and this is coming out of Google, it's the whole thing about how you can find out anything about anybody and the ability to manage what information about you that's out there. So, that whole issue, which you see a lot of on the My Space thing and all of these that are in the news now, is one. Another one, which she calls cocooning. And what that is, is the tendency of people to want to be at home surrounded by comfortable things, and so on, and that's the terrorists things and all that, create feelings of unease and insecurity. So, the cocooning of being at home and watching a DVD instead of going to a movie or that whole aspect of being at home is another one of those trends. And not to go into this topic too much, but she has 15 or 16 of these each year. And you can see if the trends are for RFID tags in backpacks, and some of this stuff hasn't happened yet, but she's predicting it will. And if I were making backpacks, I think that's an awesome idea. I would really be thinking about the first one to do that because it's on trend with Moms wanting to know where their kids are. So anyway, go to Google, put in Faith Popcorn 2006 predictions, and you'll get more of this to read than you'll ever want. But if you can adjust your business so that you're on trend, you have a much higher chance of success and that's the point I'm making.

Michael: Can you give me any particular types of businesses that I should avoid like the plague?

Joe: Types of businesses or types of products, the first one is any kind of business with a product or product you're thinking of starting a business around that requires consumer education. The best example that I can think of this is the microwave. And I don't remember who came out with it, whether it was General Electric or some big company, but it took 10 or 15 years for the consumer education to all happen before microwaves became commonplace. Now, unless you're a multi-billion dollar company, you don't have the financial wherewithal to be able to take that time. You don't have the ability to educate a consumer when something is being sold in the store on a shelf. You're not having any education with it. If you get involved with a product that needs consumer education, you can't sell it in a retail store. That's the bottom line. So, since we're talking about selling things to retail stores, that's a tilt.

The second tilt is any product or business where you can't identify your target market or you can't reach them. You may have created the ideal product for some niche group of people, but there is no list or there is no way to reach those people. So, if that's the case, for one it's a niche, so it probably doesn't go in a Wal-Mart, if it's a small niche, and if you can't reach the people, you're going to have a hard time selling it any other way too. So, that's another kind of business I don't want have anything to do with.

And the third kind is a real broad thing. Any business or product that doesn't have a clear-cut advantage over its competition, it's just "me too" thing, I'd pass on that too. So, if you don't have a clear-cut reason why the consumer should buy your product instead of somebody else's and you can provide documentation, proof, and have a clear-cut reason, if you don't have that and you're just doing a "me too" you're the 27th company that makes this identical thing, you're going to probably lose out to some other company that has more money than you because in that kind of situation it ends up being price competition and the one that wins is the biggest company that can buy the stuff the cheapest and have a lower cost, and if you're talking about starting a business, that won't be you.

Michael: How about financial issues? Can you give me some critical criteria of things I need to be thinking about related to money before I buy or start my business?

Joe: Sure, there are a few critical things. First off, get money before you need it. It's much easier to get when you don't need it. You always here that banks only loan money to people that don't need the money. There's a lot of truth in that. If you don't get money before you need it and you wait until the last minute and you're desperate, big problems. You're going to pay 10, 20 times as much for that money. In fact, one favorite trick of the venture capitalist when they are negotiating with a company that provides the money, say it's an operating company, but it needs money to expand and needs a lot of it, typical trick they play is they string you along. They say, yea we're going to fund you next month; you'll get the money in three weeks and then they see you're in bigger and bigger trouble and they stretch you out another month so you'll get in more trouble and what they'll do then is they'll get more stock for their money then because you're even more desperate. It's a pretty nasty trick, but that's what a lot of venture capital firms do that on purpose. So, you don't want to go there.

So, number one, get more money than you think you need. I've heard the rule of thumb that it's going to cost you twice as much as you think and take twice as long as you expect to do whatever you're going to do in your new business. So, get three or four times as much money as you think you need or have it available to you. And I had that happen to me, the issue of being in a desperate situation. With my second company that sold the school supplies to Wal-Mart, we were waiting for a warehouse slot. Now, a warehouse slot is allocation of a spot in the warehouse for your product and we were waiting for the warehouse slot to come through to get our order. We had been approved and we were going to get something between an $800,000 and $900,000 order and we were waiting and waiting and waiting for our warehouse slot and this was for stickers, not for school supplies.

Michael: Is this from Wal-Mart?

Joe: Wal-Mart. And we're talking a year round product, school supplies are an in and out seasonal thing so they don't go to through the warehouse, but the stickers go through the warehouse, and we were approved by the buyer. He said everything is good; you're going to get in as soon as we get the warehouse slot allocated. And the other thing Wal-Mart said, which is typical, they said once we give you the go ahead, we want you to ship in a week. Okay, if you want me to ship $800,000 of the stickers in a week, that means I better have them made already because I'm not going to be able to make them that quick. So, what that meant is I had all the products made and sitting in my warehouse, and we had to wait nine months for our warehouse slot. And what that meant, as you can imagine, the suppliers who made the stuff for me, wanted to be paid. They weren't real thrilled about waiting three or four months much less nine. So, I had to get money in a hurry and I was desperate and I went to private financers, but I ended up losing control of my company.

Michael: Where did you find these private financiers?

Joe: I found them from a friend of a friend, contact from our bank. Networking basically, and I was able to get little over a million dollars that way through contacts. But I ended up losing 60% of the company and from there on it was all down hill once they had control.

Michael: Can you paint me a picture of what happened, once they got control, why it went down?

Joe: The main thing is the people who are putting up the money were coming out of industrial businesses that change every 30 years. Once they have their money involved, they want a say in what you're doing, which in a way is understandable. But we were in a fad and fashion business. School supplies, holographic portfolios, I mean these things are going to be hot for 18 months and then dead. And people who are in ball bearings and things like that can't relate to that. They think of a good product will sell for 30 years and then maybe you make adjustments on it and it sells for 10 more. They couldn't deal with the thought of every year you've got to have new stuff and because of that they wouldn't' allocate me the money to develop new products. They just said, hey have your salesmen sell harder, go sell what you got. I mean it got ludicrous to a point. I had the buyer at Target tell us that he wasn't going to buy our stuff next year because it had run its course and I had decided I though I wanted to put Major League Baseball and NFL football and what I wanted to do was make portfolios basically out of baseball cards and football cards so that when they're done with them they can snap them apart and they would have the cards. And the buyer at Target said he would buy that. He said, that is a cool idea. I like that, I'll buy it. I go back to my investors and I tell them the buyer at Target says this other stuff is dead he's not going to buy it. He likes my new idea, he will buy it, I need $50,000 for a licensing for Major League Baseball and the NFL and they said no, go sell them what you got. So, I ended up I just left.

Michael: Okay.

Joe: At that point I left the company and a couple of years later it wound down to nothing. I saw the writing on the wall. If a buyer of a major chain tells me he's not going to buy something, I believe him. And if he tells me he'll buy something else, I believe him there too.

Michael: What kind of financing is available if I'm considering buying or starting?

Joe: There are a number of kinds of financing available. We'll talk more about it. We have a special section on nothing but financing, but typically you've got venture capitalists, which are usually for big bucks, lots of strings. You've got angel investors, which are private individualists with money, which is much better, and then you have your own personal resources or your friends and family. I would suggest not using family because if anything goes wrong then you really have personal issues along with the business issues.

So, in the next section, Section 11, which is going to deal with packaging.

Michael: This is the end of Section 10. Please continue to Section 11.